No. 14579

United States
COURT OF APPEALS
for the Ninth Circuit

E. J. MURRAY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING

Petition to Review a Decision of the Tax Court of the United States

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Petitioner respectfully requests the court to grant a rehearing of its decision of March 30, 1956, in which the court affirmed the Tax Court of the United States. Because of the apparent conflict between the court's opinion in this case and recent decisions of other divisions of this court, it would be very desirable to have this rehearing before the court *en banc*.

Petitioner represents that a rehearing is necessary in the interests of justice for the following reasons:

1. The opinion of the court on page 4 contains the statement "that there is nothing in the *Hilpert* case which calls for a contrary conclusion." The case referred to, upon which petitioner relied, is *Hilpert v. Commissioner,* 151 F. (2d) 929. Supporting the quoted statement there appears in the opinion Footnote 2, which summarizes the facts of the *Hilpert* case and contains the following statement of the holding in that case: "The effort of the Commissioner then to charge Hilpert *with a capital gain* measured by the difference between the sum of $54,364.67 and $10,635.33 and the basis, or March, 1913, value of the property, was properly overturned."

The quoted summary indicates the finding of the court to be that the *Hilpert* case did not involve the identical issue here presented, to wit, whether or not the taxpayer realized *ordinary income attributable to accumulated rentals credited* to him in the accounting. This issue in the *Hilpert* case was identical with the issue here before the court. In the decision of the Tax Court in the *Hilpert* case, 4 TC 475, appears the following statement:

> "In the deficiency notice respondent determined 'that the amount of $10,635.33, representing net rentals received by the mortgagee on Lot 4, Block 29, Reid's Addition to Orlando, Florida, and applied as a credit on your mortgage during the taxable year, constitutes ordinary income.' He also computed gain from the sale of the property at $55,764.12 by deducting from a 'sale price' of $71,-432.37 an adjusted basis of $15,668.25."

In the opinion of the Tax Court at page 477, in discussing the credit attributable to accumulated rentals,

that court stated:

> "This item is additional to and not in substitution of any part of the capital gain already dealt with . . . We conclude that petitioners' tax should be computed on $55,764.12 as long term capital gain and on $10,635.33 as ordinary income."

The opinion of the Court of Appeals for the Fifth Circuit overruled in the entirety both portions of the deficiency sustained by the Tax Court. The last paragraph of the Circuit Court's opinion deals specifically with the item resulting from the rental accruals applied as a credit and attempted to be taxed *as ordinary income*.

Perhaps the failure of the Court of Appeals for the Fifth Circuit to clearly identify the issues in its opinion misled this court into an erroneous statement of the holding of the *Hilpert* case. The sentences quoted above from the Tax Court's opinion in that case we believe clearly identify one of the principal issues in that case to be the same as that presented here. Petitioner believes that the presence of the identical issue in both cases would appear to call for an opinion on this appeal which either follows or declines to follow the *Hilpert* case.

Petitioner suggests that on re-examination of the *Hilpert* decision this court should find that the Fifth Circuit was "plainly correct" on this issue and that, as stated in that decision, "the appetite for taxes is not so voracious, the commands of the statute are not so inexorable, as to require the doing of an injustice when there is open another course that is more fully consonant with law and reason and which course, if followed, will

lead neither to evasion by the taxpayer nor extortion by the Government."

2. The court in its opinion has found taxable income from the "economic benefit which petitioner realized" and justifies its conclusion by reference to *Commissioner v. Smith,* 324 U.S. 177; *Helvering v. Bruun,* 309 U.S. 461; *Helvering v. Horst,* 311 U.S. 112. The result reached by the court is an extension of the scope of Section 22(a) of the Revenue Act substantially beyond any area in which the cited or other decisions have previously extended it.

The quoted language from the *Smith* case to the effect that Section 22(a) is broad enough to include "any economic or financial benefit conferred on the employee as compensation" has never heretofore been interpreted to find income from naked economic benefit without the additional incident of compensation *(Smith),* a transaction entered into for profit *(Bruun),* or an attempt at tax evasion *(Horst).*

The most recent pronouncement of the Supreme Court in *Commissioner v. Glenshaw Glass Company,* 348 U.S. 426, holding that Section 22(a) is broad enough to include punitive damages as taxable income, describes the area of application of the statute as follows:

> "Here we have instances of undeniable accession to wealth, clearly realized, and over which the taxpayers have complete dominion."

Footnote 8 of the same opinion indicates the belief of the court that recoveries for personal injuries are

nontaxable on the theory that they are "by definition compensatory only" and that they "roughly correspond to a return of capital."

The holding of this case appears to constitute an extension of the concept of taxable gross income to any possible situation where the taxpayer has an intangible benefit not otherwise clearly identifiable as an income item. A natural construction of the court's decision would be contrary to the Supreme Court's statement on the tax-free character of compensation for personal injury. Under the present circumstances it impliedly overrules each of the long-standing authorities cited in petitioner's brief on pages 22 and 23, and upon which the Fifth Circuit relied in the *Hilpert* case. These authorities hold that the reduction, satisfaction or cancellation of an indebtedness or obligation, which confers a benefit in that it releases encumbrances against the property of the owner, does not result in taxable income to him, where such encumbrances are not a personal obligation.

If Section 22(a) does not extend to items which "roughly correspond to a return of capital," i.e., recoveries for personal injuries which obviously affect property which has no tax base, it is difficult for petitioner to see why the credit in the accounting proceeding, through which the court attempted to compensate the petitioner for his loss of the use of capital during the years in which he was out of possession of the property, is not a similar item.

3. The far-reaching impact of the rule announced by the court justifies further analysis of the sources

from which it stems. The conclusion that the finding of a benefit is enough to generate taxable income would necessarily imply that such would have been the result in this case if the taxpayer had not exercised his option to redeem because obviously the benefit was there whether or not he took advantage of it.

Hypothetically, it might be assumed that a successful plaintiff in a contract action whose net judgment reflects the allowance of a counterclaim has taxable income to the extent of the benefit of such allowance. A further hypothetical would generate taxable income where a substantial increment to the value of property is realized because of adjoining improvements which are placed by the city or which are attributable to the improvement of their properties by adjoining owners.

4. The court's conclusion with respect to petitioner's alternate contention, which was that if any income was received it would be taxable to petitioner in each of the years commencing with 1942, rather than all in 1947, is contrary to decisions rendered by this court in cases decided between the hearing in this case and the rendition of the opinion.

There does not seem to be any dispute that under the decisions of the Oregon Supreme Court involved in this action the defendants, as stated by that court, "had been and were mortgagees in possession." Further, there seems to be no controversy that as such they were not holding the moneys under a claim of right but solely for the purpose of application of the funds upon encumbrances which the court found existed against the

property in 1942. From this petitioner argued that under the principles of law enunciated in the cases set forth on page 29 of his brief the receipt of the funds by such judicial custodians or agents constituted receipt by the petitioner. One of the cases so cited was *S. B. Tressler*. On November 10, 1955, after the hearing in this case, this court sustained the decision of the Tax Court in the *Tressler* case. In that decision (228 F. (2d) 356) it described the taxpayer's position to be one of "avoiding tax liability on income actually not in hand received but held by the Florida courts to be his although owing to others under legal obligation." In a footnote to this quoted language the court further stated (p. 359):

> "The fact that the taxpayer did not actually receive any of the revenue collected by the receiver from the operation of the apartment properties and paid to his wife, pursuant to the orders of the Florida court, does not relieve him from liability for tax thereon. The taxpayer reported his income on the cash receipts and disbursements basis and is, therefore, taxable on income when credited to him."

Obviously, the quoted language indicates an almost identical situation to the facts here, and the same rule should be applied in this case.

A further recent expression of this substantive rule is found in *Dally v. Commissioner,* 227 F. (2d) 724, decided November 21, 1955. Here this court said (p. 727):

> "Sums payable because earned are not rendered contingent and non-accrued by the mere fact that some additional acts are necessary in order to make the collection, even if these acts must be performed later by third persons or by the government."

Petitioner does not deny that, as stated by this court on page 8 of its opinion, "until the accounting was completed on February 28, 1947, and petitioner paid the amount then for the first time ascertained, he was at liberty either to redeem the property . . . . , or, if the sum arrived at did not suit him, to walk away and leave the property without redemption." The conclusion that by electing to redeem he would "thus reap the fruits of his litigation" is not factually correct as at all times since the 1942 decision the income from the property was held solely for application on the encumbrances against the property. Each of the intervening years was a period in which partial fruits of the litigation were reaped. Regardless of the action taken by petitioner in 1947, the requirement that rentals be applied to the reduction of the encumbrance against the property existed by virtue of the 1942 decision. The court's conclusion here appears to be the novel one that the taxpayer's affirmative action in electing to redeem was the thing which gave rise to taxable income. It is axiomatic that a taxpayer has no right to elect as to whether he will receive income otherwise subject to his dominion.

CONCLUSION

Petitioner respectfully suggests that the court should re-examine its analysis of the *Hilpert* case and follow that decision or, in the alternative, specifically decline to follow that case and analyze the authorities from which the conclusion is drawn that a naked benefit generates taxable income. Petitioner believes that the prin-

ciples enunciated in the opinion with respect to petitioner's alternative contention are contrary to the recent decisions of this court in the matters above referred to and that the opinion should be reviewed for the purpose of enunciating uniform principles applicable to the administration of the income tax statute.

Petitioner respectfully submits that the court was in error in affirming the judgment of the Tax Court and that this petition for a rehearing of the case *en banc* should be granted.

Respectfully submitted,

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I hereby certify that in my judgment the within petition for rehearing is well founded and is not interposed for delay.

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